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Agenda Item 4b(1)

August 15, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Revision of Real Assets – Real Estate Program Policy
- II. **PROGRAM:** Real Assets – Real Estate Program
- III. **RECOMMENDATION:** Recommend to the Investment Committee Approval of the Revised Statement of Investment Policy for Real Assets – Real Estate Program

IV. ANALYSIS:

Background

In June 2011, the Investment Committee approved adoption of the Statement of Investment Policy for Real Assets, including revisions to the Real Estate program policy. After adoption and further analysis, Real Estate staff noted that two additional interim portfolio property type limits need to be added to the policy document.

Summary of Proposed Revisions

Staff recommends proposed revisions to the Real Estate policy to add interim portfolio property type limits for 1) For Sale Residential and Land Development and 2) Other Property Types. Staff recommends approval of the interim limits for a two-year window to run from July 1, 2011 through June 30, 2013. The interim limits for each category are recommended to be increased to 15% for the two-year window from the long-term strategic limits of 10%. At expiry of the two-year period on June 30, 2013, the long-term strategic limits of 10% will apply from July 1, 2013 forward for each property type.

Staff is recommending the proposed changes as exposures to both property type categories are expected to be marginally over the respective policy limits due to the restructure of the portfolio to align with the new Strategic Plan. This restructure included a decrease in exposure limits for both categories from 20% to 10% for For Sale Residential and Land Development and 15% to 10% for Other Property Types. As of the March 31, 2011 reporting period, the exposure under the approved policy to For Sale Residential and Land Development was 11.4% and to Other Property Types, 10.3%, both over the newly established long-term strategic limits of 10%.

As a stand-alone concern, portfolio exposures in excess of limits in the two property type areas do not necessitate policy revision. However, staff anticipates that it will be necessary to consider incremental capital allocation requests in the two property type categories. While staff expects most requests to be immaterial in dollar terms, without establishment of the proposed interim limits staff will be required to seek Investment Committee approval for all incremental decisions until such time that portfolio exposures in the areas are in compliance with long-term strategic limits established in policy. Due to time and resource considerations, staff does not believe it a best use of staff and Committee Member time to bring all such requests to the Investment Committee for consideration. Adoption of the proposed interim limits will allow staff to manage the program in the applicable areas during the interim period. Staff expects portfolio exposures in the applicable categories to be in compliance with long-term strategic limits by June 30, 2013.

The new interim limits are on page 13 of the new enclosed Real Estate Program policy. There have been no other changes to the policy.

Board Real Estate Consultant Review

The Board Real Estate Consultant, PCA, has reviewed and concurs with staff's recommendation. PCA will be available at the Committee meeting to answer any questions Committee members may have regarding the proposed revised policy.

List of Attachments

- Attachment 1 - Proposed Revised Real Assets – Real Estate Program Policy
- Attachment 2 - Pension Consulting Alliance Opinion Letter

V. STRATEGIC PLAN:

The revised proposed Real Assets policy will further the following CalPERS Strategic Plan goals:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.
- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

At this time the Investment Office does not anticipate any additional cost needed to implement the proposed revised Real Assets policy.

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